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**Subject:** **Citywide Accounts Receivable Audit**

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Attached is the Citywide Accounts Receivable audit report. This performance audit examined and evaluated the accounts receivable operation to determine if accounts receivables were accurately recorded and invoiced, delinquent accounts were collected in accordance with procedures, collection agencies were properly managed, and uncollectible accounts were written off appropriately. We have completed the report in accordance with Internal Audit's (IA) fiscal year 2013/14 Audit Work Plan.

The audit revealed several internal control weaknesses that prevent the City from effectively managing accounts receivables. Internal control weaknesses stemming from inadequate policies, inefficient collection practices, limited staffing, and a lack of management review have negatively impacted the accounts receivable operation. If not addressed, these weaknesses will impair the City's ability to achieve its goals and objectives.

IA reviewed Articles III and IX of the Administrative Code, and found that the Law Department represents the City as attorney and counsel in all legal proceedings and the Finance Department has the responsibility and authority to oversee all monies due to the City. Therefore, these departments have the authority to mandate citywide compliance regarding accounts receivable policies to effectively fulfill their obligations. However, these departments have found it difficult to enforce citywide policies. Support from the City Administration may be necessary.

We would like to thank the management and staff of the Finance and Law Departments for their assistance and cooperation during this audit.

If you need any further information please contact me.

Attachment

# Citywide Accounts Receivable Audit

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March 2014



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## **Executive Summary**

Internal Audit (IA) performed an audit of the City of Cincinnati's accounts receivable operation. The audit objectives were to ensure receivables were accurately recorded and invoiced, delinquent accounts were collected in accordance with procedures, collection agencies were properly managed, and uncollectible accounts were written off appropriately.

A successful accounts receivable operation is essential for maximizing revenue collection. IA found several internal control weaknesses that prevent the City from effectively managing accounts receivables. The City's accounts receivable management process is decentralized, and departments utilize a variety of methods to manage delinquent accounts. Limited staffing resources throughout the City have also contributed to these issues. For example, the Finance Department has one employee who works approximately 16 hours per week on collections.

The Finance and Law Departments primarily manage the City's collection of delinquent accounts receivables. They have established policies governing citywide accounts receivable processes. Proper internal controls require policies and procedures addressing all aspects of managing the City accounts receivables; however, the citywide policies are inadequate and incomplete. They do not coordinate collection efforts, create uniformity, or establish collection goals for the City. In addition, departments are unable to rely on the citywide policies for creating their own, which has negatively impacted the accounts receivable operation.

Management review and oversight are key components of internal controls. The Finance Department oversees all financial transactions and reporting as they relate to accounts receivables. All expenses should be recorded, and sufficient internal controls should be in place to enable management to detect irregularities or omissions. IA found that in the Law Department, commission fees charged by outside legal counsel were not recorded, and as a result, a Form 1099-MISC was not issued. In the Finance Department, IA found commission fees paid to the collection agency exceeded the allowable amount per the contract. Additionally, the audit revealed delays in recording revenues, untimely bank deposits, and improper write-offs. Management review and oversight could have detected these irregularities.

One of the most important factors in collecting on a past due account is timeliness. IA found delays in invoicing and referring to collections. When delinquent accounts are transferred late, the chance to collect on the account decreases. Delayed referrals also increase commission fees charged by collection agencies. Proper documentation and communication of policies would help improve the timeliness of processing accounts receivables.

Overall, IA found that several opportunities for improving the accounts receivable operation exist. IA recommends establishing comprehensive accounts receivable policies and procedures, providing training, strengthening inter-departmental communication, reviewing staffing levels, centralizing collection agency oversight, implementing collection goals, and exploring opportunities for consolidating the management of delinquent accounts receivables. By addressing these internal control weaknesses, greater process control, improved revenue flow, and more efficient collection practices would be achieved.

## **I. Introduction**

### **Background**

Many City departments generate revenue from outside sources. Revenue comes in different forms, including service fees, asset recovery charges, fines, and taxes. Internal Audit (IA) estimates there were more than \$106 million<sup>1</sup> in citywide accounts receivables as of 12/31/2012.

The Law Department and the Treasury Division of the Finance Department primarily manage the City's delinquent accounts receivable collection process. They have established citywide accounts receivable policies for the departments to follow. It is the responsibility of each department to initiate the accounts receivable process by recording revenues, obtaining customer information, and sending out the initial invoice.

Departments utilizing the accounts receivable module (ARS) in the Cincinnati Financial System (CFS) to record accounts receivables send their delinquent accounts receivables to the Finance Department through an automated process when the account goes unpaid for 30 days. The Finance Department mails 3 additional delinquency notices to the debtor. Generally, if the account becomes 90 days delinquent, the account is referred to the Law Department or an outside collection agency.

Departments also have the option of using software other than ARS for recording customer data. Departments not utilizing ARS for customer billing send up to 3 invoices, then can refer their delinquent accounts directly to the Law Department. The Law Department then issues a delinquency notice to the debtor demanding payment within 30 days. If payment arrangements are not established and payment is not received, a lawsuit is filed. Pohler and Associates, LLC provides outside legal counsel to the Law Department to aid in collections.

The City also has contracts with three collection agencies: Penn Credit Corporation, Global Control Inc., and Municipal Services Bureau. Departments may individually contract with these agencies rather than using the Law Department to pursue delinquent accounts.

When accounts receivables are determined to be uncollectible, they are written off. The Finance Department writes off delinquent accounts receivables that have reached the legal statute of limitation, debt is discharged via bankruptcy, or if the debtor is deceased. Accounts receivables written off for accounting purposes may continue to be pursued by the City.

Due to the considerable involvement of the Finance and Law Departments in accounts receivable management, this report is broken into two sections. Section II addresses the responsibilities of the Finance Department, and the findings therein. Section III addresses the responsibilities of the Law Department.

### **Audit Selection**

The audit was conducted in accordance with the fiscal year 2013/14 Internal Audit work plan.

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<sup>1</sup> This figure was provided by City departments and was not audited. Please note that this reflects the estimated accounts receivable balance at a static point in time, and does not consider the delinquency of the accounts.

### **Audit Objectives**

The primary objectives of this audit were to ensure receivables were accurately recorded and invoiced, delinquent accounts were collected in accordance with procedures, collection agencies were properly managed, and uncollectible accounts were written off appropriately.

### **Audit Scope and Methodology**

This audit encompassed pertinent city staff, billing and collection transactions, and IT systems related to the accounts receivable collection process. Transactions occurring since January 1, 2012 were reviewed.

To accomplish the objectives of this audit, IA used the following methodologies: interviewed city staff, analyzed financial databases and reports, examined policies and procedures, reviewed collection agency contracts, and benchmarked practices of other cities.

### **Scope Limitations**

IA did not include receivables arising from grants or public policy of other jurisdictions, such as the State of Ohio and Hamilton County.

### **Statement of Auditing Standards**

As required by Article II, Section 15 of the City of Cincinnati Administrative Code, this audit was conducted in accordance with the Generally Accepted Government Auditing Standards (GAGAS), except for standard 3.96 pertaining to external peer review requirements. This exception did not have a material effect on the audit. Audit fieldwork was performed between August and November of 2013.

### **Commendations**

Internal Audit commends the staffs of the Finance and Law Departments on their cooperation throughout the audit.

## II. Audit Findings and Recommendations - Finance Department

*Departments lacked adequate policies and procedures for accounts receivable processes.*

Proper internal controls rely on the existence of comprehensive policies and procedures. Policies provide mandates on what should be accomplished, and procedures provide employees with instruction on how policies are to be followed. IA reviewed the policies and procedures of 15 City departments that generate accounts receivables. The departments' policies and procedures regarding accounts receivables varied significantly; some procedures were fairly comprehensive, while 6 departments did not have any. Citywide policies provide a resource from which departments can adopt their own procedures. IA found that the citywide policies were insufficient and did not apply to all departments. The Finance Department is the most knowledgeable in accounts receivable management; therefore, it is necessary that they provide policies for departments to follow. At a minimum, these policies should include accounts receivable recording, invoicing, payment posting, payment plans, write-offs, statute of limitations, deaths, bankruptcies, subsequent payment after write-offs, and collection agency management.

IA also found that the Finance Department has not established adequate internal procedures for their role in managing accounts receivables. A lack of written policies and procedures leads to inefficient and ineffective operations, and decreases management's ability to provide guidance and oversight.

**Recommendation 1:** The Finance Department should document citywide policies for managing accounts receivables that apply to both ARS and non-ARS users. They should communicate these policies and work with all departments to implement procedures.

**Department Response:** Partially agree. The Finance Department agrees with this recommendation and will work with the Law Department to draft a comprehensive Accounts Receivable Collections Policy for the City agencies that utilize the CFS system (ARS agencies). The Finance Department will share this enhanced policy with all the city agencies that do not utilize the ARS system (non-ARS agencies) and provide assistance to those agencies in developing collection policies that are consistent with the ARS policy but may be tailored to satisfy their specific business needs.

However, the Finance Department does not have the authority to mandate the non-ARS agencies follow a specific collections policy and does not have the resources to effectively monitor the collection practices of the non-ARS agencies.

**Recommendation 2:** The Finance Department should document and implement internal procedures for managing accounts receivables.

**Department Response:** Agree. The Finance Department will request a copy of the collection policies from all non-ARS agencies and offer recommendations for improvements. As indicated in the response to recommendation #1, Finance will provide assistance to the non-ARS agencies in developing policies that are consistent with the ARS policy but may be modified to meet their specific business needs.

**Internal Audit Response:** *The intent of this recommendation was to document internal procedures for Treasury Division employees specifying their responsibilities in the accounts receivable process.*

*Finance Department policies were not followed.*

The Finance Department issued policies regarding financial transactions and reporting that all departments must follow. The CFS Manual of Funds and Budgetary Accounts (Fund Manual) describes the official numerical coding structure to be used on all accounting transactions for the City. Expense account codes are referred to as object codes. According to the Fund Manual, collection agency commission fees should be charged to object code 7298. IA found some commission fees recorded by the Finance Department were improperly charged to object code 7287 (data processing by Regional Computer Center) and 7289 (expert services). Additionally, IA found that the vendor name and check number were not recorded in the payment description field in CFS. Complete and accurate financial data assists with researching and reviewing historical transactions.

The Finance Department also created the Manual of Instruction for Completion of Financial Documents (Finance Manual). It requires all City departments to submit year end financial information to the Finance Department for inclusion in the annual financial statements. IA found that the Health Department did not report all of their accounts receivable balances to the Finance Department for year ending 2012. Failure to report all balances could result in misstatements in the annual financial statements.

The Finance Manual states all money and checks shall be deposited in the Treasury Division, on the day of receipt or the following day; and supporting data shall be provided to the Finance Department at the same time. While reviewing receipts, IA found that the Law, Public Services, and Health Departments did not consistently process checks, make deposits, and record payments within 1 day of receipt as required. Delays in recording revenue could result in accounting errors, misappropriation of city funds, and redundant billing efforts.

**Recommendation 3:** The Finance Department should encourage compliance with its policies and procedures by providing training and guidance, performing spot checks, and regularly communicating its policies to each department.

**Department Response:** Partially agree. On an annual basis, the Finance Department forwards approximately 75 cash handling authorizations to all Department Directors and Division Heads. The cash handling authorization stipulates the following cash handling requirements.

- (1) The same personnel used in the issuance of permits, licenses, sale of commodities or services shall not be used in connection with the collection of monies or the keeping of records therefrom; and further, the physical facilities used in the collection of money be separated from the facility used in issuing permits or licenses or selling commodities or services.
- (2) That money, to include authorized petty cash, and records of financial transactions in the Department or Division be safeguarded against theft, fire or other loss or casualty.
- (3) Any loss of monies for whatever reason must be reported immediately to the Director of Finance and to the City Treasurer.
- (4) All city employees are bonded by blanket bond coverage and the City Treasurer will assist in taking appropriate action in filing insurance claims.



- (5) All checks and other cash items received shall be deposited in the City of Cincinnati's designated bank account or with the City Treasurer's office on the day of receipt or the following day. All supporting data covering such receipts shall be delivered to the Division of Accounts and Audits at the same time.
- (6) All checks, drafts, money orders, etc., shall be made payable to the City of Cincinnati.

Staffing limitations in the Finance Department do not allow for the development of an adequate training program or performance of spot checks. As indicated in the responses to recommendations 1 and 2, the Finance Department will provide assistance to the non-ARS agencies in order to develop consistent collections policies.

Finance will also closely monitor the invoices prepared by the ARS agencies to ensure that they are sent out within 10 days of date of service.

Note: The Internal Audit report indicates that incorrect coding is frequently used for expensing the collection agency fees. If a City agency did not include collection agency fees as an expense item in their approved budget, Finance must assign the fee to some other expense code.

***Internal Audit Response:*** *Although limited staffing may exist, encouraging compliance with the City cash handling policies is necessary to protect City assets from theft, loss or abuse.*

*Dishonored checks were not properly managed.*

Cincinnati Municipal Code 301-21 states the Director of Finance shall determine a dishonored check fee based on the cost to the City. IA found invoices for dishonored check fees for varying amounts across the City. To promote fairness and consistency across the City, a standard fee for dishonored checks should be established. IA was unable to find communication regarding bad check fees from the Finance Department.

IA also found a debtor who wrote 24 bad checks; this exceeds a reasonable limit of issuing dishonored checks. Policies preventing multiple dishonored checks are not in place.

**Recommendation 4:** The Finance Department should establish policies regarding a dishonored check fee, and require cash payments, or other less risky forms of payment, from debtors who have previously issued a dishonored check.

**Department Response:** Agree. Finance will immediately review the cost of accepting a bad check. Finance will issue a Finance Bulletin to establish a consistent bad check fee and inform all City agencies of the bad check fee.

The bad check fee will also be addressed in the new ARS Collections Policy. The new policy will also include guidelines for accepting payments from debtors that have a history of issuing multiple bad checks.

*Controls over cash handling were inadequate.*

Best practices for cash handling indicate that checks received through the mail should be safeguarded until deposited. IA found widespread examples of inadequate cash handling processes. These control weaknesses include the following: failure to log incoming checks, failure to restrictively endorse checks with a stamp upon receipt, transfers of checks through the interoffice mail system rather than in person, and failure to store undeposited checks in safes. The cash handling policies in the Finance Manual fail to address all of these weaknesses, therefore, departments do not adhere to these best practices. Strong internal controls over revenue receipts are necessary to minimize the risk of loss and theft.

**Recommendation 5:** The Finance Department should update the Finance Manual to reflect best practices over cash handling.

**Department Response:** Agree. The Finance Department will update the Finance Manual to include information on best practices for cash handling.

*Proper segregation of duties did not exist in several departments.*

Proper segregation of duties requires revenue receipting, data entry, and deposit responsibilities to be separated. IA found instances, particularly in the Law and Public Services Departments, where the same employee invoiced customers, accepted payments, recorded payment information, and made deposits. Budget cuts have left departments with minimal accounting staff. Therefore, duties can not be effectively segregated under the current operating arrangement. A lack of segregation of duties increases the risk of execution and concealment of employee theft.

**Recommendation 6:** The Finance Department should work with City departments to identify fiscal responsibilities that need to be segregated, and then determine the minimum staffing levels needed to accomplish segregation of duties. Segregation of duties can also be achieved by technological improvements or centralization of accounts receivable processing and receipting functions across the City.

**Department Response:** Disagree. Finance agrees with Internal Audit's comment that minimal accounting staff has frequently resulted in inadequate segregation of duties. However, Finance disagrees with the recommendation to provide assistance to City agencies to determine minimum staffing levels. It is the role of the Budget Division, working with division managers, to determine the appropriate staffing level for each City agency.

**Internal Audit Response:** *The intent of this finding was for the Finance Department to share their knowledge of how to properly segregate accounts receivable responsibilities with other City departments. By doing so, each department will have a better understanding of the staffing or technology needed to properly segregate duties.*

*Accounts receivables were not recorded in a timely manner.*

Billing efforts must be timely and efficient. Citywide accounts receivable policies state that the debtor is to be provided with an invoice no later than 10 days after the obligation is incurred. IA sampled invoices citywide and found 53% (107 out of 202) were not created within 10 days of

service. Of these 107 invoices, 26 were sent over 3 months past the date that the obligation was incurred. Additionally, IA found that Enterprise Technology Solutions (ETS), who was not included in the sample, regularly bills customers more than a month after the work was performed.

**Recommendation 7:** The Finance Department should ensure that departments invoice debtors in accordance with citywide policies.

**Department Response:** Partially agree. The current accounts receivable policy for ARS accounts does stipulate that all invoices should be billed within 10 days of providing service, and this stipulation will again be included in the new ARS policy. However, it is outside the control of the Finance Department as to when City agencies send out their initial invoice based on departments operational and staffing limitations.

Going forward, Finance will more closely monitor the age of the initial invoice that are sent out by the ARS agencies. However, Finance does not have the resources to closely monitor the issuance of timely invoices by the non-ARS agencies.

*Delinquent accounts were not referred in a timely manner.*

Citywide accounts receivable policies state as soon as an account has become 90 days delinquent, the account shall be referred by the Finance Department to a collection agency or the Law Department. Currently, the Finance Department obtains approval from the department prior to referral. IA found 32% (117 out of 371) of delinquent accounts receivables tested were over 100 days old when referred to the collection agency. Additionally, 53% (67 out of 127) of delinquent accounts receivables tested were over 100 days old when referred to the Law Department. Delaying the collections process increases the risk of being unable to collect on the account. The citywide accounts receivable policies exclude guidelines for delaying or prohibiting a delinquent account from being referred to collections.

**Recommendation 8:** The Finance Department should refer delinquent accounts receivables to collection agencies or the Law Department as soon as the account goes unpaid for 90 days. Any exceptions should be documented and thoroughly explained. Delinquent accounts receivables not referred to collections should be reviewed periodically to determine the status of the account.

**Department Response:** Agree. Delinquent accounts should be referred to the Law Office or collection agencies when they become 90 days delinquent. This provision is already included in the current ARS collections policy.

**Recommendation 9:** The Finance Department should establish guidelines in the citywide accounts receivable policies for overriding or delaying the referral of delinquent accounts receivables to collections.

**Department Response:** Agree. A provision will be included in the new ARS policy that any exceptions to submitting accounts to Law/Collection Agency at 90 days must be approved by the City Treasurer.

*Policies regarding write-offs should be expanded.*

Generally, accounts receivables are written off to reflect a more realistic view of collectability. The citywide accounts receivable policies state accounts are to be written off due to death, foreclosure, or if the account is over 5 years old. IA found that the Law Department has different criteria, and writes off delinquent accounts due to bankruptcy, incarceration, death, settlements, or if an individual's sole source of income is from social security benefits. Failure to create uniform policies causes inefficient operations. For example, IA found 67% (18 out of 27) of bankruptcies sampled were not written off by the Finance Department within 30 days of the bankruptcy discharge date.

**Recommendation 10:** The Finance Departments should work with the Law Department to establish citywide accounts receivable policies specifying all reasons for which an account may be written off.

**Department Response:** Agree. The Finance Department will work with the Law Department to establish more detailed criteria regarding the write-off of delinquent accounts. This detailed write-off criteria will be included in the new comprehensive ARS collections policy. This new policy will then be shared with the non-ARS agencies so they can be incorporated into their collection policies.

Note: It is our experience that bankruptcy notices are sent by the courts to many different city agencies, and they are not all forwarded to Finance or Law. A provision will be included in the new ARS collections policy that all bankruptcy notices be immediately forwarded to Law.

*Accounts receivables were modified and written off without proper approval.*

The Finance Department requires all accounts receivable write-offs be approved by the City Treasurer, although this is not explicitly documented. IA found that accounts written off by the Law Department were not approved by the City Treasurer. IA also found 70 accounts written off by the Department of Public Services that were not approved by the City Treasurer in 2012. This practice could result in improper write-offs going undetected.

Modifications to accounts receivables do not require approval by the City Treasurer. IA found several invoices from various departments that were modified without explanation or management approval. This internal control weakness increases the risk of an invoice balance being reduced in error.

**Recommendation 11:** The Finance Department should establish policies and procedures requiring the City Treasurer's approval prior to writing off or modifying accounts receivables.

**Department Response:** Agree. The Finance Department's policy is that the City Treasurer is solely responsible for the write-off of delinquent accounts. Finance will work with the Law Department to clarify the responsibilities for write-off of delinquent accounts, and this will be incorporated into the new ARS collections policy.

For City agencies that utilize the ARS system, approval must be obtained from the City Treasurer's office before invoices can be adjusted or cancelled. Finance does not have this same control for the invoices prepared by the non-ARS agencies and does not have the resources to closely monitor those invoices.

*Uncollectible accounts were not written off in a timely manner.*

The citywide accounts receivable policies indicate accounts receivables older than 5 years are to be written off. IA found that \$1.5 million in delinquent accounts receivables that should have been written off in 2012 due to statute of limitations, but were processed in 2013. IA also found accounts receivables written off prior to 5 years, with the description “due to statute of limitations”. A thorough review prior to approving and writing off accounts will help prevent errors. Failure to properly write off accounts receivables could have an impact on the balances reflected in the annual financial statements.

Additionally, accounts receivable policies and procedures state that the account will be written off if the debtor is deceased. The Department of Public Services sent an invoice to an individual whom they had record of being deceased. Resources were unnecessarily wasted by attempting to collect on a deceased individual’s account.

Departments that do not use ARS shall get the City Treasurer’s approval, then write off accounts in their customer tracking database. IA compared the City Treasurer’s write-off approval log to write-offs made by the Department of Public Services in 2012. IA found 97% (36 out of 37) of write-offs approved were not written off by the Department of Public Services. Improper and omitted write-offs could lead to inaccurate reporting of accounts receivable balances.

**Recommendation 12:** The Finance Department should review the accounts receivable aging schedule on a monthly basis and write off the appropriate delinquent accounts receivables in accordance with policy.

**Department Response:** Partially agree. The Finance Department will review the aging schedule for the ARS accounts on a monthly basis and will write off delinquent accounts on a monthly basis. (The current practice has been to perform this function on a quarterly basis.) This monthly review stipulation will be included in the new comprehensive ARS collections policy.

**Recommendation 13:** The Finance Department should thoroughly review write-off requests, and inquire upon requests presented prior to statute of limitations, before approving and writing off the account.

**Department Response:** Partially agree. Finance prepares the write-off requests for the ARS agencies. For the non-ARS agencies, Finance does not have the resources to conduct a thorough analysis of their write-off requests. Many of the non-ARS agencies have more resources and personnel dedicated to the accounts receivable function greater than current staffing in Finance. Therefore, without additional staff the Finance Department will rely on the research and explanations provided by the non-ARS agencies when they submit their write-off requests.

**Recommendation 14:** The Finance Department should require departments to reconcile write-offs to write-off approval reports and investigate and resolve discrepancies.

**Department Response:** Partially agree. The Finance Department does not have the authority to mandate the non-ARS agencies to reconcile their write-off reports. Also, Finance does not have the resources to investigate and resolve discrepancies in the write-off reports of the non-ARS agencies.

*Not all accounts receivables were recorded in ARS.*

The Finance Department requires all financial transactions to be entered into CFS on an aggregate level. CFS contains an accounts receivable module (ARS) for tracking, recording, and invoicing debtors, but is not required to be used by departments. It is more practical for departments that have a high volume of customers to use other software; however, IA found departments that have a low volume of accounts receivables, such as the Health Department, Park Board, and Lunken Airport, use other software to manage accounts receivables, when it appears they could use ARS without impacting service. To maintain consistency across the organization, all departments should use ARS for recording accounts receivables whenever practical. Uniformity across the organization decreases software costs and improves ease of use. Additionally, other processes such as collections, write-offs, and litigation would be improved by having those processes performed in a centralized environment.

**Recommendation 15:** The Finance Department should require all City agencies to utilize ARS for recording accounts receivables whenever practical.

**Department Response:** Agree. The Finance Department would encourage Health, Parks, and Lunken Airport to utilize the ARS system for their accounts receivable function. This allows Finance to better monitor the receivables and control the collections process. However, Finance does not have the authority to mandate that any city agencies utilize the ARS system.

*Departments that use separate customer and financial databases for accounts receivables have not consistently reconciled the two systems.*

ARS does not have the capability to manage detailed customer data, therefore, departments use Permits Plus, U-Tax, and Customer Suite, among others, to track customer billing information. IA found that departments using a non-ARS system for managing accounts receivables do not reconcile with CFS. Reconciliations are necessary to identify omissions, errors, and potential fraud in recording receipts. Failure to reconcile data could cause fraud and errors to go unnoticed, and cause billing issues.

Departments stated they had issues attempting to reconcile other systems to CFS because they are not notified when a payment has been received. When a payment on an account receivable is received by the Finance or Law Department, the payment is entered into CFS. Although the payment is not directly communicated back to the department, they have access to CFS from which to retrieve the payment detail and input that information into their accounts receivable database. Departments did not know they could access payment information this way, because they lack proper training. This lack of training led to duplicated collection efforts, poor customer service, and inaccurate records.

**Recommendation 16:** The Finance Department should require departments that do not use ARS to reconcile accounts receivable data in their system with CFS on a monthly basis.

**Department Response:** Agree. The Finance Department does not have the authority to mandate City agencies reconcile the data in their own system to the data in CFS on a monthly basis.

**Recommendation 17:** The Finance Department should provide training for all applicable accounts receivable staff throughout the City on the capabilities and features of CFS.

**Department Response:** Partially agree. Lack of resources has made it very difficult for Finance to provide City-wide training on the CFS system. Training in recent years has been provided by Finance on an individual basis to City agencies. If additional resources are provided, Finance agrees to provide training to all City agencies utilizing the ARS system on the capabilities and features of CFS.

*Commission charges were not in compliance with contract terms.*

Collection agencies charge the City a commission for collecting revenue on delinquent accounts receivables. After receiving payment from the debtor, the collection agencies subtract their fee and remit the net payment along with the statement to the City. The collection agencies' contracts include a fee schedule, which specifically lists the agreed upon commission rates. Collection agencies' commission fees range from 16% to 27% of the amount collected. Additional rates and fees are charged for added services. IA reviewed 25 payments received by the Finance Department from the collection agency during 2012 and recalculated the commission charge. IA found 52% (13 out of 25) of the commission fees were higher than the allowable amount. If these irregularities go undetected or unresolved, the City would pay more commission fees than required by contract.

**Recommendation 18:** The Finance Department should recalculate the commission fees on a monthly basis. Additionally, any charges not in compliance with the contract terms should be investigated.

**Department Response:** Agree. Finance agrees with this recommendation. All billing statements provided by the collection agencies for the ARS accounts are now closely monitored and billing discrepancies are resolved in a timely manner.

*Collection agency activity was not reconciled.*

According to the collection agency contract, the City requires several monthly collection status reports. IA requested the monthly status reports from the Finance Department for March, June, September, and December 2012 to determine if the reports were received and reviewed. IA was informed that the collection agency did not send the reports as required by the contract. IA expanded testing and compared the collection agency 2012 collection status report with the Finance Department's records to check for variances. IA found discrepancies in the number of accounts assigned to the collection agency, the dollar value of accounts assigned and commission paid. When brought to the attention of the Finance Department, these items were immediately investigated and reconciled.

Due to budget cuts the Finance Department staff has been reduced over recent years. Currently the Finance Department has 1 employee who dedicates 16 hours per week to managing delinquent accounts receivables and collection agencies. To operate efficiently, proper management of delinquent accounts receivable and collection agencies requires sufficient staffing and resources. The department objectives will not be achieved without appropriate staffing resources in place.

**Recommendation 19:** The Finance Department should request that the collection agency send monthly and annual collection status reports as stated in the contract. These reports should be reconciled with the Finance Department's collection data on a monthly basis to ensure amounts assigned, collected, cancelled, and outstanding are accurate and reliable. Any errors or discrepancies should be investigated and resolved.

**Department Response:** Agree. The collection agency utilized by Finance does send a monthly report on all active accounts. This report is then used to post payments and update the payment status in the CFS system. Finance does not request a monthly report from the collection agency on inactive accounts as that report would be of little or no use – it would simply be repetitive and show no payments being made. On an annual basis, Finance will request a comprehensive report that covers both active and inactive accounts.

**Recommendation 20:** The Finance Department should evaluate the workload required for delinquent accounts receivable management, and if needed, hire additional staff or consolidate responsibilities.

**Department Response:** Agree. There are two employees (an Accountant and an Accounting Tech 1) in the Finance Department that are involved in delinquent account collections. As indicated in the audit report, the Accountant position spends approximately 16 hours per week on delinquent accounts. The Accounting Tech 1, who is responsible for mailing invoices, depositing payments, preparing cash receipt schedules, and updating payment records in CFS, spends approximately 12 hour per week working on the delinquent accounts.

The Finance Department agrees that a significant amount of additional resources would be required to address many of the recommendations included in this audit report, particularly those recommendations that apply to the non-ARS agencies. Unfortunately, staffing over the past 10 years has been reduced to conduct audits, provide training, and administer the delinquent accounts collections. At one time, there was one position in Finance dedicated solely to pursuing delinquent accounts, and a position dedicated solely to performing field audits. Even the current Accountant position that administers the delinquent accounts function for Finance was eliminated from approved budget at the beginning of the 2014 fiscal year. After much discussion with the Budget Department in the first few months of the fiscal year, the position was added back to the approved budget in October 2013.

*The performance of the collection agency was not measured or evaluated.*

To have an effective collection management system, monitoring the collection rate and evaluating collection agency performance is essential. Reviewing performance assists management with determining whether the department is maximizing revenue recovery. IA found that the Finance Department did not establish collection goals, and the collection agency's performance was not evaluated. Without measurement controls or performance indicators in place, management is unable to determine if the collection agency is meeting the needs of the department.

Status reports allow management to analyze trends, evaluate performance measures, and determine if collection agency performance meets the department goals and objectives. Without regularly monitoring the collection agency performance, there is an increased risk that the department collection goals may not be achieved.



**Recommendation 21:** The Finance Department should establish collection goals and objectives.

**Recommendation 22:** The Finance Department should evaluate the collection agency's performance on a consistent basis to ensure that collection goals are being met.

**Department Response:** Agree. Finance will establish collection goals for the collection agencies utilized for the ARS accounts. However, the past three years the ARS collection rate has exceeded 96% which is an excellent rate of collection.

**Internal Audit Response:** *Evidence of the collection rate was not provided by the Finance Department during the audit. IA does not attest to this calculation.*

*Contracts for collection services were not reevaluated.*

Best practices indicate that long-term contracts should be reevaluated periodically for relevance to current business conditions and department objectives. The City has utilized the same 3 collection agencies for at least 6 years. These contracts have automatically renewed, causing the contracts to go unreviewed since initially awarded. New contracts could lower costs, improve collection agency performance, and increase revenue.

**Recommendation 23:** The Finance Department should follow best practices and reevaluate all contracts for collection services.

**Department Response:** Agree. The Purchasing Division has just completed a bid process for City-wide collection agency services. The bid for Accounts Receivable Collections was issued on December 10, 2013 and closed on January 10, 2014. Eight bids received, and awards were subsequently made to five firms. The new contracts will become effective on April 1 2014.

These are City-wide contracts, allowing each City agency to utilize the collections firm that most suits their specific needs.

### III. Audit Findings and Recommendations - Law Department

*Many departments lack adequate policies and procedures for accounts receivable processes.*

Proper internal controls rely on the existence of comprehensive policies and procedures. IA found that citywide policies regarding accounts receivables were inadequate. The Law Department's expertise in accounts receivable management and debt collection is needed to assist the Finance Department in creating citywide policies for departments to follow.

IA also found that the Law Department has not established internal procedures regarding their role in managing accounts receivables. Written procedures addressing the Law Department's responsibilities are necessary to provide guidance and oversight, and to improve efficiency and effectiveness.

**Recommendation 24:** The Law Department should work with the Finance Department to document citywide policies for managing accounts receivables.

**Recommendation 25:** The Law Department should document and implement internal procedures for managing accounts receivables.

**Department Response:** Agree. Law has internal procedures in place. Law is currently working on placing those procedures in writing. The Law Department will work directly with the Finance Department to implement consistent policies and procedures.

*A system for communicating incorrect addresses has not been implemented.*

Policies requiring communication of incorrect addresses to the Law Department have not been established. City departments mail invoices, and then receive returned mailings if the address is incorrect. Once the delinquent account is referred to the Law Department, another delinquency notice is generated and mailed to the same invalid address. The Law Department utilizes a public records database to find the correct address after receiving returned mail. This step could be performed prior to the automatically generated notice if returned mailings are properly communicated by the departments creating a more efficient process. Repeated mailing of invoices to invalid addresses increases postage fees, lengthens collection turnaround time, and heightens the risk of not collecting on the account.

**Recommendation 26:** The Law Department and the Finance Department should work together to establish an efficient process for communicating undeliverable mail. The citywide accounts receivable policies should be revised to include the new process.

**Department Response:** Agree. Citywide policies must be directed by the City Manager. The Law and Finance Departments do not have the authority to direct the activities of other departments.

*Policies regarding bankruptcies were not communicated to departments.*

Citywide accounts receivable policies state bankruptcy notices should be forwarded to the Law Department within 48 hours of receipt. This policy was only communicated to ARS users. IA found that Greater Cincinnati Water Works was unaware that bankruptcy notices were to be

communicated to the Law Department. After a bankruptcy is filed and approved, any acts to obtain money or other property from a debtor is prohibited. A creditor or those acting on behalf of the creditor, who had knowledge of the bankruptcy, may be held in contempt of court if pursued. Therefore, it is imperative that the Law Department be informed of all debtors who have filed bankruptcy.

**Recommendation 27:** The Law Department should work with the Finance Department to establish policies requiring all City departments to communicate approved bankruptcy notices to the Law Department.

**Department Response:** Agree. There should be a unified approach to bankruptcy cases. The Law and Finance Departments do not have the authority to require other departments to take particular actions. Such directives must come from the City Manager.

*Delinquent accounts were not referred to the Law Department in a timely manner.*

The Law Department considers 90 days the optimal time for them to begin the delinquent account collection process; however, this is not a city policy. IA found 53% (67 out of 127) of the delinquent accounts receivables tested were over 100 days old when referred to the Law Department. Additionally, the Income Tax Bureau does not send referrals to the Law Department in a timely manner. IA also found that the Department of City Planning and the Health Department do not refer all delinquent accounts receivables to the Law Department. The longer the delay in referring accounts to the Law Department, the lower the chance of collection.

**Recommendation 28:** Citywide accounts receivables policies should be updated to require departments to refer delinquent accounts receivables to the Law Department as soon as the account has become 90 days delinquent.

**Department Response:** Agree. The Law Department lacks the authority to impose such a requirement or Citywide adherence to collections policies, but agrees that the Administration should implement this recommendation.

*Uncollectible accounts were not written off in a timely manner.*

Generally, accounts receivables are written off to reflect a more realistic view of collectability. The citywide accounts receivable policies state accounts are to be written off due to death, foreclosure, or if the account is over 5 years old. The Law Department writes off accounts receivables due to bankruptcy, incarceration, death, or if an individual's sole source of income is from social security benefits. The Law Department has not determined a statute of limitations, causing account receivables to remain on the books for many years beyond collectability.

**Recommendation 29:** The Law Department should determine if accounts meet the write-off criteria specified by the citywide accounts receivable policies, and if so, obtain Finance Department's approval and write off the accounts.

**Department Response:** Agree. Law and Finance should use one set of mutually agreed write-off policies. The Law Department will work directly with the Finance Department to implement consistent policies and procedures. Both departments have implemented a procedure for the

Law Department to provide a write-off report each month, and the Finance Department will review this report and approve the write-offs.

*Commission fees paid to outside legal counsel were not recorded.*

Outside legal counsel charges the City a commission for collecting revenue on delinquent accounts receivables. After receiving payment from the debtor, legal counsel subtracts their fee, and remits the net payment amount along with the statement summary to the City. To properly account for expenses, all commission fees should be recorded in CFS. IA found that commission fees charged by outside legal counsel were not recorded by the Law Department in 2012 and prior. As a result of not recording commission fees, a Form 1099-MISC was not issued. The IRS specifically requires Form 1099-MISC be issued to report payments made for legal services.

**Recommendation 30:** The Law Department should work with the Finance Department to determine the appropriate course of action needed to correct commission expense inaccuracies and Form 1099-MISC reporting omissions.

**Department Response:** Agree. Law began providing yearly report to Finance in 2013 so a 1099 may be issued and will continue to provide those reports.

**Internal Audit Response:** *The response does not address corrective action regarding the prior 1099-MISC reporting omissions.*

*The Law Department does not maintain critical data in their database.*

A database serves as a useful tool for management to quickly review important accounts receivable information. A few years ago, the Law Department switched databases. During the transition the invoice dates recorded in the old database did not transfer over to the new database. The initial invoice date of when the service was provided is needed to determine the delinquency of the account. Without this information tracking accounts receivables and determining the account delinquency becomes a tedious task.

Additionally, when delinquent accounts are referred to the Law Department, the invoice number is removed and a case number is assigned to track the account. The invoice number is a unique identifier that provides a means for tracking delinquent accounts.

**Recommendation 31:** The Law Department should record the initial invoice date and the invoice number in the database.

**Department Response:** Agree. Collection database currently includes invoice number. The database is being updated to include invoice date.

*Improvements are needed for the Law Department's database.*

Generally, the database's reporting function allows users to view and print a summary of transactions and totals, by day, month or year. IA requested a report that shows the total amount received from the collection agency in 2012 and was informed that the information is

recorded in the database; however, the database would need to be modified to produce a report that would only show payments received from a specific collection agency in 2012. The database reporting capabilities are limited and may require IT assistance to generate other pertinent collection status reports needed for proper review of collection agencies.

**Recommendation 32:** The Law Department should determine the reporting capabilities needed to properly review collection status data and improve the collection management process. The database should be modified to accommodate the needs of the department.

**Department Response:** Agree. The City should spend capital resources to obtain a collections database system that will allow the City to undertake a unified collections operation. With proper resources, Law could house this operation and maintain the database.

*Departments' referral process and interdepartmental communication was not efficient.*

Streamlining data transmission creates a more efficient process for managing delinquent accounts receivables. Some departments submit referrals electronically, while other departments send paper files. Referrals sent electronically are easily uploaded in the Law Department's database. If all departments submitted their referrals and supporting documentation electronically, this would create a uniform data transmission process and increase efficiency.

A sufficient process for communicating all delinquent accounts receivables incurred by the debtor is needed to ensure legal staff resources are used efficiently. IA was informed that in some cases, Law Department staff exerts duplicate efforts to collect from the debtor. When a lawsuit is filed, legal staff is not always aware of all outstanding balances owed by the debtor. For example, the debtor may have delinquent accounts receivables with multiple City departments. If unknown when appearing in court; the City will miss an opportunity to pursue all claims simultaneously, and may have to schedule another court hearing to resolve all balances. Taking measures to streamline the communication process would minimize the risk of Law Department staff devoting additional time and resources to pursue the same debtor twice.

**Recommendation 33:** The Law Department should consult with the departments and IT to determine compatibility, streamline data transmissions, improve the communication process, and enhance inter-departmental coordination.

**Department Response:** Agree. The City should spend capital resources necessary to allow the City to undertake a unified collections operation. With proper resources, Law could house this operation and maintain the database.

*The Law Department was unable to view payments made at the departments.*

The Law Department provides collection services for nearly all City departments. Some debtors pay on their delinquent accounts at the department that performed the service, and others pay the Law Department. The Law department does not have access to department payment records and must rely on the department to notify them of a payment. This process is inefficient and can become time consuming when inquiring on the status of payments.

**Recommendation 34:** The Law Department should request read-only access to all departments' accounts receivable databases.

**Department Response:** Agree. The City Manager should direct all departments to provide such access to the Law Department. The Law Department has no authority to require departments to provide access.

*The Law Department has not collected fees for court cost.*

Court costs incurred to pursue delinquent accounts are paid up front by the City. The City was entitled to collect these fees from the debtor, but did not. IA was informed these fees were not added to the claim because the database was not programmed to accommodate a charge for court costs. As a result, the City missed an opportunity to be reimbursed. IA found that the City paid approximately \$90,000 in court costs during 2012.

**Recommendation 35:** The Law Department should seek reimbursement for court costs, and modify the database to accommodate these transactions.

**Department Response:** Partially agree. This raises a question of legal judgment related to each particular case that the Law Department brings. Our lawyers make judgments within the bounds of legal ethics and the realities of what the City will be able to collect on the particular case. We will take this recommendation under advisement. The Law Department database has been revised to record the potential court costs and the collection of court costs if the costs are paid.

*Legal counsel collection activity was not reconciled.*

The Law Department's outside legal counsel is required to provide status update reports on a regular basis. Reconciling monthly collection reports is a control activity that assists staff with detecting errors or misstatements, and provides insight regarding the cause of an error. IA compared the collection statement for 2012 to the Law Department's payments received, and found that the collection totals do not match. IA was informed that a reconciliation of the timing differences in collection activity is not prepared by the department. Additionally, the Law Department does not prepare monthly reconciliations to ensure that all payments were entered properly and applied to the correct account. IA also found collection agency payments written out to specific departments that were applied to other departments. Preparing monthly reconciliation reports would improve the department collection management process and provide an adequate internal control for detecting errors and discrepancies. Status reports also allow management to analyze trends, evaluate performance measures, and determine if collection agency performance meets the department goal and objectives. Without regular monitoring of the collection agency performance, there is an increased risk that the department collections goals may not be achieved.

**Recommendation 36:** The Law Department should reconcile collection data on a monthly basis to ensure data is accurate and reliable. A reconciliation of amounts assigned, collected, cancelled, and outstanding should be performed on a monthly basis. Any errors or discrepancies should be investigated and resolved.

**Department Response:** Agree. Accounts are reconciled as payments are received. Additional reports have been added to assist in a monthly reporting status.

*The performance of outside legal counsel was not measured or evaluated in writing.*

To have an effective collection management system, monitoring the collection rate and evaluating collection agency performance is essential. Reviewing performance assists management with determining whether or not the department is reaching maximum revenue recovery. IA found that the Law Department has not established collection goals and the collection agency's performance was not evaluated in writing. Without measurement controls or key indicators in place, management is unable to determine if the collection agency performance is meeting the needs of the City.

**Recommendation 37:** The Law Department should establish collection goals and objectives. Additionally, the goals should be communicated to all parties involved in collection agency oversight.

**Recommendation 38:** The Law Department should evaluate the outside legal counsel's collection performance on a consistent basis to ensure that collection goals are being met.

**Department Response:** Agree. As we do with all outside counsel contracts, the Law Department oversees and monitors the practices of our collections counsel. We regularly consider the merits of continuing to use outside counsel and have met with collections agencies to consider their services. Our outside collections counsel receives the cases that are most difficult to collect on. The easy cases are resolved by the departments. We will consider whether setting a goal makes sense in the context of legal ethics and the realities of particular cases.

*Contracts for collection services were not reevaluated.*

Best practices indicate that long-term contracts should be reevaluated periodically for relevance to current business conditions and department objectives. The Law Department has utilized the same firm for outside legal counsel for over 5 years. This agreement has automatically renewed, causing the contract to go unreviewed since initially awarded. A new contract could lower costs, improve collection agency performance, and increase revenue.

**Recommendation 39:** The Law Department should follow best practices and reevaluate the current contract for collection services.

**Department Response:** Agree. As we do with all outside counsel contracts, the Law Department oversees and monitors the practices of our collections counsel. We regularly consider the merits of continuing to use outside counsel and have met with collections agencies to consider their services.

*The City's collection agencies were managed inefficiently.*

The Cincinnati Municipal Code, Section 301-19, permits City departments to contract with collection agencies as they wish. Currently, 4 departments have contracts with 4 different collection agencies. Accounts at or below \$200 are referred to a collection agency, and

accounts greater than \$200 are referred to the Law Department. This policy would need to be removed to improve the collection management process and maximize benefits of using collection agencies. The referral process could be simplified if all departments refer accounts over 90 days to a centralized location designated to manage collections.

**Recommendation 40:** The City should consolidate management and oversight of collection agencies to a centralized location. The citywide accounts receivable policies should be revised to reflect this change in operations.

**Department Response:** Strongly agree. A centralized collection operation would address many of the concerns raised in this audit and provide a more efficient process which would most likely result in increased revenues for the City.



#### **IV. Conclusion**

Establishing an effective accounts receivable operation is necessary to maximize revenue collection. A strong accounts receivable operation is essential, considering the economic conditions the City is facing. Internal control weaknesses stemming from inadequate policies, inefficient collection practices, limited staffing, and a lack of management review, has negatively impacted the accounts receivable operation.


Overall, IA found that several opportunities for improving the accounts receivable operation exist. IA recommends establishing comprehensive accounts receivable policies and procedures, providing training, strengthening inter-departmental communication, reviewing staffing levels, centralizing collection agency oversight, implementing collection goals, and improving technology.

Best practices indicate the most effective collection strategies involve centralizing collections, increasing staff, using automated collection software, and better utilization of collection agencies. One possible solution for the City is to centralize collection efforts of the Treasury Division and the Law Department and establish one collection team devoted to managing delinquent accounts receivables. By addressing these internal control weaknesses, greater process control, improved revenue flow, and more efficient collection practices would be achieved.

## **V. Finance and Law Departments Responses**

March 20, 2014

To: Lauren Sundararajan, Internal Audit Manager

From: Reginald Zeno, Finance Director 

Copies:

Subject: Finance Department Response to the Accounts Receivable Collections Audit

Attached is the Finance Department response to the Accounts Receivable Collections Audit.

Attachment

## Finance Response to Internal Audit of Accounts Receivable Collections

The City of Cincinnati has a de-centralized system in place for processing and collecting accounts receivable. The Finance Department – Treasury Division administers the delinquent account collections for the City agencies that utilize the ARS module within the Cincinnati Financial System. City agencies that utilize the ARS module to process receivables are provided in the table below.

The following table provides an accounts receivable summary for the ARS accounts for the years 2011 through 2013.

City Agency	# of Invoices	Amount Invoiced	Amount Paid	Collection %
Fire	1,280	\$ 1,313,880	\$ 1,283,740	97.71%
Lunken Airport	972	3,559,626	3,442,115	96.70%
MSD	1,807	20,616,564	19,781,886	95.95%
Parking	1,156	3,009,169	3,000,180	99.70%
ETS	735	19,842,589	20,163,398	101.62%
Public Services	488	1,139,842	993,348	87.15%
Police	4,780	6,101,423	5,930,672	97.20%
Traffic Engineering	235	140,980	151,387	107.38%
Fleet Services	327	925,911	734,347	79.31%
Recreation	875	1,407,211	1,347,774	95.78%
Buildings and Insp.	2,402	9,350,630	8,293,201	88.69%
Engineering	5,714	4,152,657	4,017,279	96.74%
Totals	20,771	\$ 71,560,482	\$ 69,139,327	96.62%

(Note: This table includes data for all invoices processed via the ARS system, including invoices paid after the 1<sup>st</sup> invoice. Total ARS receivables at December 31, 2013 (not including Buildings and Inspections) were \$4,845,835. Of this total, \$1,088,757 is receivables more than 90 days old.)

The focus of the Finance Department has been on amount of revenue collected, and the overall collections rate has exceeded 96% for the 2011 through 2013 time period. Finance is generally pleased with this collections performance, especially considering that there are minimal tools available to enforce the collection of these invoices. Enforcement actions for delinquent ARS receivables are generally limited to reporting the debt to the credit bureaus and the Law Department filing suits for invoices that exceed \$1,000.

Many City agencies do not utilize the ARS module and are responsible for processing their own receivables. The non-ARS agencies include Income Tax , Water Works, Law, Office of Administrative Hearings, Parks, and Health. These agencies utilize receivables systems that are more tailored to their specific business needs.

The Internal Audit Report indicates there is a need for the Law Department and Finance to work together to prepare a comprehensive accounts receivable policy that can be utilized on a City-wide basis. The Finance Department agrees with this recommendation and will begin working immediately with the Law Department to draft a comprehensive ARS policy. This new policy will be used for all the

City agencies that utilize the ARS module and for the delinquent accounts that are administered by the Law Department.

The Internal Audit report also recommends that Finance be more involved in the collections process for the non-ARS agencies and provide training to those agencies on best practices. Finance agrees to share the new collections policy with all the non-ARS agencies and work with the agencies to develop an effective collections policy. However, Finance does not have the resources to supervise and monitor their collections programs or provide extensive training programs.

Unfortunately, the trend over the past decade has been to reduce the resources available to the Finance Department to conduct audits, provide training, and administer the delinquent accounts collections. At one time, there were positions in Finance dedicated solely to pursuing delinquent accounts and conducting field audits of departments. Even the one position that Finance now has to administer delinquent accounts collections was eliminated for a brief period of time. The position was initially cut from the approved budget for the 2014 fiscal year, leaving Finance with no resources at all for collecting delinquent accounts. After much discussion with the Budget Department in the first few months of the fiscal year, the position was added back to the Finance budget in October 2013.

A significant amount of additional resources would be required to address many of the recommendations included in this audit report, particularly those recommendations that apply to the non-ARS agencies. At this time, Finance has an Accountant that spends approximately 40% of their time on administering delinquent accounts and an Accounting Technician that spends about 30% of their time processing delinquent accounts. Without additional resources, the Finance Department is incapable of implementing many of the recommendations proposed in the Internal Audit report.

**Recommendation 1:** The Finance Department should document citywide policies for managing accounts receivables that apply to both ARS and non-ARS users. They should communicate these policies and work with all departments to implement procedures.

Response: The Finance Department agrees with this recommendation and will work with the Law Department to draft a comprehensive Accounts Receivable Collections Policy for the City agencies that utilize the CFS system (ARS agencies). The Finance Department will share this enhanced policy with all the city agencies that do not utilize the ARS system (non-ARS agencies) and provide assistance to those agencies in developing collection policies that are consistent with the ARS policy but may be tailored to satisfy their specific business needs.

However, the Finance Department does not have the authority to mandate the non-ARS agencies follow a specific collections policy and does not have the resources to effectively monitor the collection practices of the non-ARS agencies.

**Recommendation 2:** The Finance Department should document and implement internal procedures for managing accounts receivables.

Response: The Finance Department will request a copy of the collection policies from all non-ARS agencies and offer recommendations for improvements. As indicated in the response to recommendation #1, Finance will provide assistance to the non-ARS agencies in developing policies that are consistent with the ARS policy but may be modified to meet their specific business needs.

**Recommendation 3:** The Finance Department should encourage compliance with its policies and procedures by providing training and guidance, performing spot checks, and regularly communicating its policies to each department.

Response: On an annual basis, the Finance Department forwards approximately 75 cash handling authorizations to all Department Directors and Division Heads. The cash handling authorization stipulates the following cash handling requirements.

- (1) The same personnel used in the issuance of permits, licenses, sale of commodities or services shall not be used in connection with the collection of monies or the keeping of records therefrom; and further, the physical facilities used in the collection of money be separated from the facility used in issuing permits or licenses or selling commodities or services.
- (2) That money, to include authorized petty cash, and records of financial transactions in the Department or Division be safeguarded against theft, fire or other loss or casualty.
- (3) Any loss of monies for whatever reason must be reported immediately to the Director of Finance and to the City Treasurer.
- (4) All city employees are bonded by blanket bond coverage and the City Treasurer will assist in taking appropriate action in filing insurance claims.
- (5) All checks and other cash items received shall be deposited in the City of Cincinnati's designated bank account or with the City Treasurer's office on the day of receipt or the following day. All supporting data covering such receipts shall be delivered to the Division of Accounts and Audits at the same time.

(6) All checks, drafts, money orders, etc., shall be made payable to the City of Cincinnati.

Staffing limitations in the Finance Department do not allow for the development of an adequate training program or performance of spot checks. As indicated in the responses to recommendations 1 and 2, the Finance Department will provide assistance to the non-ARS agencies in order to develop consistent collections policies.

Finance will also closely monitor the invoices prepared by the ARS agencies to ensure that they are sent out within 10 days of date of service.

Note: The Internal Audit report indicates that incorrect coding is frequently used for expensing the collection agency fees. If a City agency did not include collection agency fees as an expense item in their approved budget, Finance must assign the fee to some other expense code.

**Recommendation 4:** The Finance Department should establish policies regarding a dishonored check fee, and require cash payments, or other less risky forms of payment, from debtors who have previously issued a dishonored check.

Response: Finance agrees with this recommendation, and will immediately review the cost of accepting a bad check. Finance will issue a Finance Bulletin to establish a consistent bad check fee and inform all City agencies of the bad check fee.

The bad check fee will also be addressed in the new ARS Collections Policy. The new policy will also include guidelines for accepting payments from debtors that have a history of issuing multiple bad checks.

**Recommendation 5:** The Finance Department should update the Finance Manual to reflect best practices over cash handling.

Response: The Finance Department agrees with this recommendation and will update the Finance Manual to include information on best practices for cash handling.

**Recommendation 6:** The Finance Department should work with City departments to identify fiscal responsibilities that need to be segregated, and then determine the minimum staffing levels needed to accomplish segregation of duties. Segregation of duties can also be achieved by technological improvements or centralization of accounts receivable processing and receipting functions across the City.

Response: Finance agrees with Internal Audit's comment that minimal accounting staff has frequently resulted in inadequate segregation of duties. However, Finance disagrees with the recommendation to provide assistance to City agencies to determine minimum staffing levels. It is the role of the Budget Division, working with division managers, to determine the appropriate staffing level for each City agency.

**Recommendation 7:** The Finance Department should ensure that departments invoice debtors in accordance with citywide policies.

Response: The current accounts receivable policy for ARS accounts does stipulate that all invoices should be billed within 10 days of providing service, and this stipulation will again be included in the new ARS policy. However, it is outside the control of the Finance Department as to when City agencies send out their initial invoice based on departments operational and staffing limitations.

Going forward, Finance will more closely monitor the age of the initial invoice that are sent out by the ARS agencies. However, Finance does not have the resources to closely monitor the issuance of timely invoices by the non-ARS agencies.

**Recommendation 8:** The Finance Department should refer delinquent accounts receivables to collection agencies or the Law Department as soon as the account goes unpaid for 90 days. Any exceptions should be documented and thoroughly explained. Delinquent accounts receivables not referred to collections should be reviewed periodically to determine the status of the account.

Response: The Finance Department agrees that delinquent accounts should be referred to the Law Office or collection agencies when they become ninety days delinquent. This provision is already included in the current ARS collections policy.

**Recommendation 9:** The Finance Department should establish guidelines in the citywide accounts receivable policies for overriding or delaying the referral of delinquent accounts receivables to collections.

Response: The Finance Department agrees with this recommendation. A provision will be included in the new ARS policy that any exceptions to submitting accounts to Law/Collection Agency at 90 days must be approved by the City Treasurer.

**Recommendation 10:** The Finance Departments should work with the Law Department to establish citywide accounts receivable policies specifying all reasons for which an account may be written off.

Response: The Finance Department will work with the Law Department to establish more detailed criteria regarding the write-off of delinquent accounts. This detailed write-off criteria will be included in the new comprehensive ARS collections policy. This new policy will then be shared with the non-ARS agencies so they can be incorporated into their collection policies.

Note: It is our experience that bankruptcy notices are sent by the courts to many different city agencies, and they are not all forwarded to Finance or Law. A provision will be included in the new ARS collections policy that all bankruptcy notices be immediately forwarded to Law.

**Recommendation 11:** The Finance Department should establish policies and procedures requiring the City Treasurer's approval prior to writing off or modifying accounts receivables.

Response: The Finance Department's policy is that the City Treasurer is solely responsible for the write-off of delinquent accounts. Finance will work with the Law Department to clarify the responsibilities for write-off of delinquent accounts, and this will be incorporated into the new ARS collections policy.

For City agencies that utilize the ARS system, approval must be obtained from the City Treasurer's office before invoices can be adjusted or cancelled. Finance does not have this



same control for the invoices prepared by the non-ARS agencies and does not have the resources to closely monitor those invoices.

**Recommendation 12:** The Finance Department should review the accounts receivable aging schedule on a monthly basis and write off the appropriate delinquent accounts receivables in accordance with policy.

Response: The Finance Department agrees to review the aging schedule for the ARS accounts on a monthly basis and will write off delinquent accounts on a monthly basis. (The current practice has been to perform this function on a quarterly basis.) This monthly review stipulation will be included in the new comprehensive ARS collections policy.

**Recommendation 13:** The Finance Department should thoroughly review write-off requests, and inquire upon requests presented prior to statute of limitations, before approving and writing off the account.

Response: Finance prepares the write-off requests for the ARS agencies. For the non-ARS agencies, Finance does not have the resources to conduct a thorough analysis of their write-off requests. Many of the non-ARS agencies have more resources and personnel dedicated to the accounts receivable function greater than current staffing in Finance. Therefore, without additional staff the Finance Department will rely on the research and explanations provided by the non-ARS agencies when they submit their write-off requests.

**Recommendation 14:** The Finance Department should require departments to reconcile write-offs to write-off approval reports and investigate and resolve discrepancies.

Response: The Finance Department does not have the authority to mandate the non-ARS agencies to reconcile their write-off reports. Also, Finance does not have the resources to investigate and resolve discrepancies in the write-off reports of the non-ARS agencies.

**Recommendation 15:** The Finance Department should require all City agencies to utilize ARS for recording accounts receivables whenever practical.

Response: The Finance Department would encourage Health, Parks, and Lunken Airport to utilize the ARS system for their accounts receivable function. This allows Finance to better monitor the receivables and control the collections process. However, the Finance does not have the authority to mandate that any city agencies utilize the ARS system.

**Recommendation 16:** The Finance Department should require departments that do not use ARS to reconcile accounts receivable data in their system with CFS on a monthly basis.

Response: The Finance Department does not have the authority to mandate City agencies reconcile the data in their own system to the data in CFS on a monthly basis.

**Recommendation 17:** The Finance Department should provide training for all applicable accounts receivable staff throughout the City on the capabilities and features of CFS.

Response: Lack of resources has made it very difficult for Finance to provide City-wide training on the CFS system. Training in recent years has been provided by Finance on an individual basis to City agencies. If additional resources are provided, Finance agrees to provide training to all City agencies utilizing the ARS system on the capabilities and features of CFS.

**Recommendation 18:** The Finance Department should recalculate the commission fees on a monthly basis. Additionally, any charges not in compliance with the contract terms should be investigated.

Response: Finance agrees with this recommendation. All billing statements provided by the collection agencies for the ARS accounts are now closely monitored and billing discrepancies are resolved in a timely manner.

**Recommendation 19:** The Finance Department should request that the collection agency send monthly and annual collection status reports as stated in the contract. These reports should be reconciled with the Finance Department's collection data on a monthly basis to ensure amounts assigned, collected, cancelled, and outstanding are accurate and reliable. Any errors or discrepancies should be investigated and resolved.

Response: The collection agency utilized by Finance does send a monthly report on all active accounts. This report is then used to post payments and update the payment status in the CFS system. Finance does not request a monthly report from the collection agency on inactive accounts as that report would be of little or no use – it would simply be repetitive and show no payments being made. On an annual basis, Finance will request a comprehensive report that covers both active and inactive accounts.

**Recommendation 20:** The Finance Department should evaluate the workload required for delinquent accounts receivable management, and if needed, hire additional staff or consolidate responsibilities.

Response: There are two employees (an Accountant and an Accounting Tech 1) in the Finance Department that are involved in delinquent account collections. As indicated in the audit report, the Accountant position spends approximately 16 hours per week on delinquent accounts. The Accounting Tech 1, who is responsible for mailing invoices, depositing payments, preparing cash receipt schedules, and updating payment records in CFS, spends approximately twelve hour per week working on the delinquent accounts.

The Finance Department agrees that a significant amount of additional resources would be required to address many of the recommendations included in this audit report, particularly those recommendations that apply to the non-ARS agencies. Unfortunately, staffing over the past ten years has been reduced to conduct audits, provide training, and administer the delinquent accounts collections. At one time, there was one position in Finance dedicated solely to pursuing delinquent accounts, and a position dedicated solely to performing field audits. Even the current Accountant position that administers the delinquent accounts function for Finance was eliminated from approved budget at the beginning of the 2014 fiscal year. After much discussion with the Budget Department in the first few months of the fiscal year, the position was added back to the approved budget in October 2013.

**Recommendation 21:** The Finance Department should establish collection goals and objectives.

Response: Finance will establish collection goals for the collection agencies utilized for the ARS accounts. However, the past three years the ARS collection rate has exceeded 96% which is an excellent rate of collection.

**Recommendation 22:** The Finance Department should evaluate the collection agency's performance on a consistent basis to ensure that collection goals are being met.

Response: See response to recommendation # 21.

**Recommendation 23:** The Finance Department should follow best practices and reevaluate all contracts for collection services.

Response: The Purchasing Division has just completed a bid process for City-wide collection agency services. The bid for Accounts Receivable Collections was issued on December 10, 2013 and closed on January 10, 2014. Eight bids received, and awards were subsequently made to five firms. The new contracts will become effective on April 1 2014.

These are City-wide contracts, allowing each City agency to utilize the collections firm that most suits their specific needs.

## **Law Department Response**

**General Response:** This audit presents the City with an opportunity to fix a fractured collection process. The Law Department welcomed the audit because we hoped that it would highlight an important inefficiency in the City's collection operations, which the Law Department had not been able to rectify on its own. The City's collection operations are diffuse, with different departments engaging in their own collections efforts. This is driven partly by how the City historically has accounted for collections receipts. Departments feel that they need to keep collections within their own silos in order to keep or get credit for the money that they receive. This leads to inefficiency, such as multiple departments attempting to collect from the same individual, accounts growing stale before action is taken, et cetera. It also has led to the hiring of multiple third-party collections firms with varying degrees of oversight.

The audit alludes to some of these issues, but does not convey the full scale of the problem and how it can be solved. The Law Department's view, which it expressed throughout the audit, is that the City should consolidate its collections operations. This consolidation can take one of two forms: (1) allow one department (likely Finance or Law, or a division under the Manager) to take over collections for all City departments; or (2) completely outsource the City's entire collections function to a third-party collections firm. Our view is that either approach would increase collections substantially and that additional costs would be far less than the additional collections received.

The Law Department provides a useful example of this. In 2010, the Administration allowed the Law Department to add staff to enhance its collections operations. Since that time, collections have increased each year. In 2013, the Law Department collected more than \$1.4 million in outstanding receivables. By comparison, from 2006 to 2009, collections averaged approximately \$430,000 per year. The increased collections have far exceeded the costs of additional staff.

In sum, the audit raises some internal process issues that the Law Department has or will address. We thank the Internal Audit division for its guidance in these areas. But the most significant outcome of this audit is lost in the minutiae of process. The most significant opportunity presented by the audit is the clear need for administrative action directing centralized collection. The Law Department's specific responses are listed below.

**Recommendation 24:** The Law Department should work with the Finance Department to document citywide policies for managing accounts receivables.

**Recommendation 25:** The Law Department should document and implement internal procedures for managing accounts receivables.

**Law Department Response:** Law has internal procedures in place. Law is currently working on placing those procedures in writing. The Law Department will work directly with the Finance Department to implement consistent policies and procedures.

**Recommendation 26:** The Law Department and the Finance Department should work together to establish an efficient process for communicating undeliverable mail. The citywide accounts receivable policies should be revised to include the new process.

**Law Department Response:** Agree. Citywide policies must be directed by the City Manager. The Law and Finance Departments do not have the authority to direct the activities of other departments.

**Recommendation 27:** The Law Department should work with the Finance Department to establish policies requiring all City departments to communicate approved bankruptcy notices to the Law Department.

**Law Department Response:** Agree that there should be a unified approach to bankruptcy cases. The Law and Finance Departments do not have the authority to require other departments to take particular actions. Such directives must come from the City Manager.

**Recommendation 28:** Citywide accounts receivables policies should be updated to require departments to refer delinquent accounts receivables to the Law Department as soon as the account has become 90 days delinquent.

**Law Department Response:** The Law Department lacks the authority to impose such a requirement or Citywide adherence to collections policies, but agrees that the Administration should implement this recommendation.

**Recommendation 29:** The Law Department should determine if accounts meet the write-off criteria specified by the citywide accounts receivable policies, and if so, obtain Finance Department's approval and write off the accounts.

**Law Department Response:** Agree that Law and Finance should use one set of mutually agreed write-off policies. The Law Department will work directly with the Finance Department to implement consistent policies and procedures. Both departments have implemented a procedure for the Law Department to provide a write-off report each month, and the Finance Department will review this report and approve the write-offs.

**Recommendation 30:** The Law Department should work with the Finance Department to determine the appropriate course of action needed to correct commission expense inaccuracies and Form 1099-MISC reporting omissions.

**Law Department Response:** Law began providing yearly report to Finance in 2013 so a 1099 may be issued and will continue to provide those reports.

**Recommendation 31:** The Law Department should record the initial invoice date and the invoice number in the database.

**Law Department Response:** Collection database currently includes invoice number. The database is being updated to include invoice date.

**Recommendation 32:** The Law Department should determine the reporting capabilities needed to properly review collection status data and improve the collection management process. The database should be modified to accommodate the needs of the department.

**Law Department Response:** Agree that the City should spend capital resources to obtain a collections database system that will allow the City to undertake a unified collections operation. With proper resources, Law could house this operation and maintain the database.

**Recommendation 33:** The Law Department should consult with the departments and IT to determine compatibility, streamline data transmissions, improve the communication process, and enhance inter-departmental coordination.

**Law Department Response:** Agree that the City should spend capital resources necessary to allow the City to undertake a unified collections operation. With proper resources, Law could house this operation and maintain the database.

**Recommendation 34:** The Law Department should request read-only access to all departments' accounts receivable databases.

**Law Department Response:** Agree that the City Manager should direct all departments to provide such access to the Law Department. The Law Department has no authority to require departments to provide access.

**Recommendation 35:** The Law Department should seek reimbursement for court costs, and modify the database to accommodate these transactions.

**Law Department Response:** This raises a question of legal judgment related to each particular case that the Law Department brings. Our lawyers make judgments within the bounds of legal ethics and the realities of what the City will be able to collect on the particular case. We will take this recommendation under advisement. The Law Department database has been revised to record the potential court costs and the collection of court costs if the costs are paid.

**Recommendation 36:** The Law Department should reconcile collection data on a monthly basis to ensure data is accurate and reliable. A reconciliation of amounts assigned, collected, cancelled, and outstanding should be performed on a monthly basis. Any errors or discrepancies should be investigated and resolved.

**Law Department Response:** Accounts are reconciled as payments are received. Additional reports have been added to assist in a monthly reporting status.

**Recommendation 37:** The Law Department should establish collection goals and objectives. Additionally, the goals should be communicated to all parties involved in collection agency oversight.

**Recommendation 38:** The Law Department should evaluate the outside legal counsel's collection performance on a consistent basis to ensure that collection goals are being met.

**Law Department Response:** As we do with all outside counsel contracts, the Law Department oversees and monitors the practices of our collections counsel. We regularly consider the merits of continuing to use outside counsel and have met with collections agencies to consider their services. Our outside collections counsel receives the cases that are most difficult to collect on. The easy cases are resolved by the departments. We will consider whether setting a goal makes sense in the context of legal ethics and the realities of particular cases.

**Recommendation 39:** The Law Department should follow best practices and reevaluate the current contract for collection services.

**Law Department Response:** As we do with all outside counsel contracts, the Law Department oversees and monitors the practices of our collections counsel. We regularly consider the merits of continuing to use outside counsel and have met with collections agencies to consider their services.

**Recommendation 40:** The City should consolidate management and oversight of collection agencies to a centralized location. The citywide accounts receivable policies should be revised to reflect this change in operations.

**Law Department Response:** Strongly agree. A centralized collection operation would address many of the concerns raised in this audit and provide a more efficient process which would most likely result in increased revenues for the City.